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TAX FOUNDATION'S VOLUME 28, NO. 8, NOVEMBER-DECEMBER 1984

TAX·FEATURES

MHT's McGillicuddy Named For TF's 1984 Public Service Award

Tax Foundation's 36th National Conference will zero in on the two-way squeeze in which the Federal government finds itself, as spending and indebtedness continue to outpace revenues. A cross-section of policy specialists and economists will address various facets of this dilemma during the day-long meeting on December 5 at New York's Plaza Hotel.

Leif H. Olsen, Chairman Economic Policy Committee, Citibank, N.A., will keynote the conference, addressing the topic "Taxpayers versus Tax Spenders: Who's Less Honest?" Murray L. Weidenbaum, Director of the Center for Study of American Business at Washington University and recent Chairman of the President's Council of Economic Advisers, will follow, on the topic of "The Way Out of the Budget Quandary: The Need for Budget Cuts." John E. Chapoton, Partner, Vinson & Elkins, and former Assistant Secretary of the Treasury for Tax Policy, will conclude the morning's session with a talk on "The Evolution of the Tax System and Implications for the Future."

Horace W. Busby, political analyst and former top aide to Lyndon B. Johnson, will take the podium at the conference luncheon. His topic will be "The Politics of Changing Taxes."

The afternoon session of the meeting will be devoted to a "Systematic Review of the Income Tax" by two Price Waterhouse executives: Bernard M. Shapiro, National Director of Tax Policy, and Larry L. Dildine, Director of Tax Economics. Leonard E. Kust, Partner, Cadwalader, Wickersham & Taft, and Herbert J. Lerner, Vice Chairman-Tax Services, Ernst & Whinney, will sum up the conference's deliberations at the end of the day.

Tax Foundation's 47th Annual Dinner will take place that evening, also at The Plaza. John F. McGillicuddy, Chairman of the Board and Chief Executive Officer of Manufacturers Hanover Corporation and Manufacturers Hanover Trust Company, will receive the Foundation's Distinguished Public Service Award for 1984. W. Bruce Thomas, Tax Foundation's Chairman and Vice Chairman-Administration and Chief Financial Officer of U.S. Steel Corporation, will preside and make the presentation.

For further details and reservations, please call (202) 822-9050, or write Tax Foundation, One Thomas Circle, N.W., Suite 500, Washington, D.C. 20005.

Indexing Starts Jan. 1, Low Earners Helped Most

Taxpayers will save about $8 to $10 billion on their 1985 tax bills when indexing of the personal income tax system kicks in this January, according to economists at the Tax Foundation. And those in the low- and middle-income levels will benefit the most, they say.

Indexing is much more valuable to lower-income families as a percentage of their tax liability than to the upper-income household. The family with the $12,000 adjusted gross income sees its tax bill reduced by $45 - or 8.3 percent due to the increase in the personal exemption and the zero bracket amount. As income rises, the dollar amount of the tax saving also rises, but at a lesser percent of tax paid.

Tax Foundation economists explain that indexing takes the hidden tax of inflation out of the individual income tax system, by wiping out the "fiscal dividend" of inflation-related tax increases.

The reason low- and middle-income taxpayers benefit most is that the personal exemption and the zero bracket amount will be indexed, as well as the rest of the marginal rate brackets. Taxpayers who itemize their deductions will receive no benefit from having the zero bracket amount indexed. Because they reduce their taxable income by the excess of their itemized de-

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Effect of Indexing on Federal Income Tax for Families at Selected Income Levels[a]

Tax Year 1985

Adjusted gross income	Amount of tax in 1985[b] Without indexing	With indexing	Reduction in tax with indexing Amount	Percent
$ 12,000	$ 539	$ 494	$ 45	8.3
20,000	1,741	1,682	59	3.4
30,000	3,067	2,983	84	2.7
40,000	5,043	4,901	142	2.8
50,000	7,424	7,198	226	3.0
75,000	14,570	14,249	321	2.2
100,000	22,715	22,295	420	1.8
200,000	59,170	58,464	706	1.2
500,000	172,100	171,327	773	0.4

[a]Married couple with one earner, two children, filing joint return. All income is assumed to be from wages and salaries.

[b]Assumes zero bracket amount for the two lowest income levels and itemized deduction for the other brackets at the same percentage of income for each level as in 1981.

Source: Tax Foundation computations based on 1984 data (without indexing) from Department of the Treasury, adjusted by 4.1% increase in the Consumer Price Index from fiscal 1983 to fiscal 1984.

"State-local public monthly payrolls hit $18.2 billion in October 1983—up $1 billion from 1982."

(INDEXING, from page 1)
ductions over the zero bracket amount, any gain itemizers realize from an increase in the zero bracket amount is exactly offset by the reduction in excess itemized deduction.

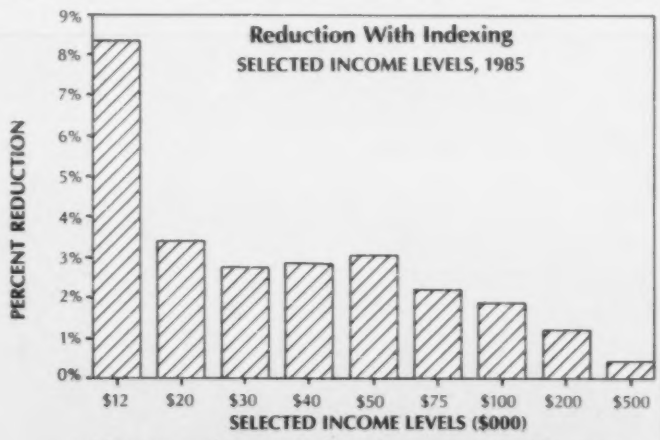
Taxpayers at the upper end of the scale, however, do benefit from the larger personal exemption and wider brackets introduced into the scale. The accompanying table details the reduction in tax liability for selected income levels in 1985. Based on the 4.1 percent increase in the indexing factor, the major changes for 1985 are:

- personal exemption rises from $1,000 to $1,040;
- zero bracket amount (formerly the standard deduction) rises from $3,400 to $3,540 for married taxpayers and from $2,300 to $2,390 for singles.

Introduced as part of the Economic Recovery Tax Act of 1981, indexing automatically adjusts the individual income tax brackets, the zero bracket amount, and the personal exemption for the previous year's rate of inflation. This prevents inflation from shifting taxpayers into higher and higher tax brackets (with successively higher marginal rates).

Indexing was not part of the original tax package promoted by the Reagan Administration nor of the Democratic alternative. It was injected into the bidding war to sway about eight Democratic votes to the President's package. Since 1981 there have been numerous calls to repeal, defer, or modify the automatic adjustment before it actually takes hold on January 1, 1985.

Now that the first measurement period has passed, the withholding tables for wages earned in 1985 can be recalculated, and it is appropriate to review the likely impact of indexing and the policy implications involved. The provision itself is remarkably short and simple. The Department of Treasury must calculate the average percentage increase in the CPI for the year October 1983 through September 1984 over the previous 12-month period. The index numbers are published monthly by the Bureau of Labor Statistics. Multiply the personal exemption and the dollar brackets in the rate tables by that factor to complete the adjustment. This operation removes about 85 percent of the inflation-induced increase in tax revenues.



Indexing is much more valuable to lower-income families as a percentage of their tax liability than to the upper-income household. The family with the $12,000 adjusted gross income sees its tax bill reduced by $45 or 8.3 percent due to the increase in the personal exemption and the zero bracket amount. As income rises, the dollar amount of the tax saving also rises, but at a lesser percent of tax paid.

Employment Starts Climb At State-Local Levels After 2-Year Decline

Growth in state-local public employment started up again in 1983 after two years of decline, according to economists at the Tax Foundation. Thirty states plus the District of Columbia recorded more workers on their job rolls. The increase was not impressive, however, as state-local employment, measured in numbers of full-time equivalent employees, crept up by just over half a percentage point. Nationwide in fiscal 1983, 10.88 million employees were on the job versus 10.83 million in the previous year.

This most recent hike follows consecutive decreases for fiscal years 1981 and 1982—the only declines in state-local job rolls recorded since World War II, say Tax Foundation researchers. Except for the 1981-82 recession, state-local employment has risen continuously since the mid-1940s. The all-time record for persons employed by state-local governments goes to 1980, when there were 11.0 million such public employees.

Between 1973 and 1983, non-Federal public employment growth averaged nearly 1.3 percent annually. For every 100 persons employed by states and localities in 1973, over a dozen more had been added to the rolls by 1983, Foundation researchers report, based on analysis of annual data prepared by the Bureau of Census.

State and local government employment also has increased in relation to the population at large. In fiscal 1983 public employees numbered 465 for every 10,000 in the population—up from 456 per 10,000 a decade earlier.

State-local public monthly payrolls hit $18.2 billion in October 1983—up $1 billion from 1982. By comparison, state-local payrolls totalled "just" $8.0 billion in 1973. Between October 1982 and October 1983, these outlays increased 6.2 percent. For the ten-year span since 1973, they averaged 8.6 percent annual growth.

Total growth for the decade just ending (1973-83) showed a 14 percent increase in state-local employees and a 128 percent increase in payrolls.

Average monthly earnings per employee doubled during the decade. For the month of October 1983, state and local governments nationwide paid employees an average $1,674, up from $836 in 1973.

Top pay was in Alaska ($2,746), while Mississippi paid its employees least ($1,171). After Alaska came the District of Columbia, California, and Michigan

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Tax Features

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State-Local Pension Assets at Record Level

Financial assets held by state and local government pension systems reached a record $289.7 billion at the end of fiscal year 1983. They grew $44.5 billion (18.1 percent) that year, Tax Foundation economists report. Because of this and earlier increases, assets of these systems are now almost three times as large as they were in 1975. These holdings account for about 26 percent of the $1 trillion now salted away in all public and private pension fund holdings in the United States.

Contributions from government employers, employees, and earnings on accumulated assets fund state and local retirement systems. Annual receipts from all sources in fiscal 1983 totaled $57.9 billion, an increase in $9 billion (18.3 percent) over 1982. For the 12 months, benefit payments to about 3.1 million retirees and other withdrawals from the funds increased only $1.5 billion or 8.3 percent.

The size of asset holdings and their investment performance have become increasingly important in financing the systems. From fiscal 1982 to 1983, earnings on the accumulated assets jumped by 38 percent. For the first time such earnings became the major single source of receipts for the pension funds. Investment earnings provided $26.3 billion to the funds (45.4 percent of the year's receipts). Government employers contributed 39.6 percent, and the 10.4 million active employee members put in only 15.0 percent.

Traditionally, state and local governments—not earnings on investments—have been the primary contributor to the pension funds. In the 1970s government provided between 45 percent and 49 percent of pension funds receipts, while employee contributions ranged from 19 percent to 28 percent of the total. As recently as 1970, investment earnings contributed only 25.0 percent of annual fund receipts.

The 194 systems administered by state governments account for the bulk of the asset holdings of the 2,534 separate systems. The state systems, most of which also include many local employees, hold 79 percent of the financial assets of all systems combined. According to the Bureau of the Census, which compiles annual data, about 95 percent of participants belong to one of the 168 systems with 5,000 or more members. Two-thirds of the total number of plans of state and local governments had fewer than 100 enrolled members at the end of fiscal 1983.

Earnings on investments account for the largest segment of retirement system receipts in 33 of the 50 states. In 14 states they provide 50 percent or more. Government contributions account for the largest segment in the remaining 17 states and the District of Columbia.

As investment portfolios of these pension systems have expanded, their composition has also changed. Today, holdings of corporate bonds, corporate stocks, and Federal securities comprise over three-fourths of the assets.

Corporate bonds make up the largest segment of state-local assets—27.2 percent in fiscal 1983. At the same time, their relative share has declined in recent years, as measured against a share of 40.1 percent in 1962, and 55.1 percent in 1972.

Corporate stocks today account for about one quarter of the dollar value of all assets. Two decades ago they comprised a mere 3 percent of the assets.

Federal securities make up about one quarter of financial assets today, as they did in the early 1960s.

State-local securities have almost dropped off the charts. In 1962, they made up nearly one-fifth of the total. Today they account for less than a single percentage point.

Mortgages have stayed generally around 8 percent to 9 percent of total. About 3 percent of asset value is now in cash and deposits, up from just over 1 percent for most earlier years.

The table below provides further details.

"Earnings on investments account for the largest segment of retirement system receipts in 33 of the 50 states."

(STATE-LOCAL EMPLOYMENT, from page 2)

($2,263, $2,101, and $1,978, respectively).

Just above Mississippi, the lowest payrolls per employee were recorded for Arkansas, South Carolina, and West Virginia ($1,220, $1,305, and $1,311, respectively).

Payroll per employee in Wyoming rose the most rapidly—up 160.9 percent for the ten-year period. Next were North Dakota (140.0 percent), Alaska (131.2 percent), Utah (130.6 percent), New Mexico (125.2 percent), Montana (124.0 percent), Texas (119.6 percent), and Colorado (119.3 percent).

The lowest growth in payroll per employee was in Hawaii (up 76.0 percent for the decade), followed by New Jersey (up 84.8 percent), Missouri (88.9 percent), Connecticut (91.5 percent), and Pennsylvania (91.7 percent).

Alaska showed the decade's highest growth of the 50 states both in employment levels (up 68.3 percent) and in public payrolls (up 289.2 percent).

For a state-by-state breakdown of state and local government employment and payrolls, month of October 1973 and 1983, please write to the Tax Foundation.

Assets and Annual Receipts of State and Local Employee Retirement Systems by Source

Selected Fiscal Years, 1960-1983

(Millions)

Year	Cash and security holdings	Receipts by source: Total	Employee contributions	Government contributions	Earnings on investments
1960	$ 18,539	$ 3,393	$1,140	$ 1,652	$ 601
1965	31,814	5,260	1,626	2,418	1,216
1970	54,918	9,848	2,788	4,600	2,460
1971	61,605	11,310	3,159	5,241	2,910
1972	68,760	12,620	3,400	5,750	3,471
1973	78,417	14,878	4,166	6,649	4,064
1974	87,488	16,527	4,207	7,821	4,500
1975	98,064	18,898	4,488	9,116	5,294
1976	111,322	21,037	4,808	10,502	6,327
1977	123,481	25,347	5,233	12,369	7,744
1978	142,637	28,032	5,681	13,660	8,681
1979	161,700	31,949	6,069	15,336	10,544
1980	185,226	37,313	6,466	17,532	13,315
1981	210,427	43,441	7,289	20,020	16,133
1982	245,252	48,961	8,123	21,808	19,030
1983	289,731	57,906	8,699	22,936	26,271

Source: U.S. Department of Commerce, Bureau of the Census; and Tax Foundation computations.

"In fiscal 1982, state-local governments shelled out 24.4 cents of their general budget dollars for local public schools."

Budget Will Grow For Public Education During Next Decade

Rising enrollments and renewed interest in improving public schools over the next decade may alter the recent decline in the share of state-local budgets spent on local public schools, according to Tax Foundation analysts.

The 1984-85 school year will mark the end of a 12-year period of falling enrollments nationwide. Beginning in the fall of 1985, projections of the National Center for Education Statistics (NCES) suggest that enrollments will begin to rise slowly during the remainder of the 1980s, reaching 41,078,000 pupils by the 1992-93 school year.

From school year 1982-83 through school year 1992-93, student enrollments will increase by about 1.4 million (4 percent). During the previous ten years, they declined by 6.1 million (13 percent). (See accompanying table.) The jump in elementary school attendance (grades K-8) will more than offset expected reductions in secondary grades (9-12). These projections assume that there will be annual increases in the younger school-age population during the period, according to Tax Foundation researchers.

Since the turn of the century, local public schools have been the costliest service provided by state and local governments. In 1983-84 they will cost taxpayers an estimated $126.9 billion. Despite the vast expansion in other services such as public welfare and higher education, local schools have maintained their claim of between 24 and 30 cents of every dollar spent by these governments. In fiscal 1982 (latest data available), state-local governments shelled out 24.4 cents of their general budget dollars for local public schools. This was nearly 4 cents lower than in 1972 when the share was 27.7 cents of a considerably smaller spending budget.

Between 1972 and 1982, while all other spending by state-local governments rose by 160 percent, local school outlays climbed by 127 percent, even though enrollments fell by 13 percent. (The rise in public school costs during the 1962-1972 decade had been much sharper—163 percent.)

Tax Foundation economists note that the recent moderation in the growth of public school costs mirrors enrollment reductions, placing restraints on current school expenses, coupled with some slowing in the growth of capital spending for school buildings, and in the rate of increases in teachers' salaries.

Enrollments in public elementary and secondary schools peaked in the fall of 1971 at 46,081,000, according to the NCES. Since then, the number of pupils has declined. It is expected to reach a low of around 39,000,000 in the fall of 1984, in tandem with the decline in 5-to-17 year-olds in the population.

Along with rising pupil enrollments, the NCES also foresees a turnaround in the decline in inflation-adjusted teachers' salaries. With the possibility of teacher shortages in the late 1980s, salaries are expected to rise again and return to the higher real levels of the early 1970s.

Trends in Enrollment and Instructional Staff in Public Elementary and Secondary Schools

1972-73 to 1992-93[a]

Enrollment/ teachers	Number (thousands)			Percent change	
	1972-73	1982-83	1992-93	1972-73 to 1982-83	1982-83 to 1992-93
Enrollment,					
Total	45,744	39,643	41,078	−13	+ 4
K-8	31,831	27,143	30,025	−15	+11
9-12	13,913	12,501	11,053	−10	−12
Classroom teachers,					
Total	2,103	2,110	2,299	0	+ 9
K-8	1,140	1,165	1,379	+ 2	+18
9-12	963	945	920	− 2	− 3

[a]Projected

Source: U.S. Department of Education, National Center for Education Statistics; and Tax Foundation computations.

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TAX·FEATURES

6.9% State-Local Tax Growth Marks 2nd Smallest Rise Since 1963

State-local taxes chalked up the smallest gain in four years during fiscal year 1983, as they registered an increase of 6.9 percent over fiscal 1982, Tax Foundation economists report. The $284.6 billion collected in 1983 topped 1982's tax take by $18.3 billion.

With the exception of 1979, the 1983 increase in tax collections was the leanest in twenty years. In 1979, the impact of California's Proposition 13 held state-local tax revenues to a 6.1 percent increase. These figures, according to analysts at the Washington-based tax watchdog organization, are for general taxes—all levies except unemployment insurance.

While total increases were modest, property and individual income tax collections advanced rather strongly, says the Tax Foundation. Property taxes rose 9.0 percent in fiscal 1983 from the previous year, and individual income taxes increased 8.6 percent. General sales taxes rose 7.1 percent. Corporate income taxes dropped 5.2 percent, and other major tax sources showed relatively small increases.

Not reflected in the record of general tax collections for the year was a sharp hike in unemployment insurance levies paid by business employers, according to Tax Foundation researchers. These taxes jumped from $15.8 billion in 1982 to $20.7 billion in 1983, a 31 percent rise, and brought total state-local taxes—general and other—above the $300 billion mark for the first time. At $305.3 billion in fiscal 1983, total state-local taxes were $23.2 billion or 8.2 percent higher than in the previous year.

In contrast to 1983, fiscal 1984 may turn out to be a banner year for state-local tax collectors, according to Foundation analysts. Advance reports from the Bureau of the Census, covering the 12 months ending June 30, 1984, reveal that state-local general taxes alone totaled $320.5 billion, an increase of $36.6 billion or 13.7 percent from the same period one year earlier.

Over the last decade, from 1973 to 1983, state-local taxes rose by 135 percent, an annual average of 8.9 percent. State taxes grew at a faster pace than local collections throughout the 1970s. General state taxes increased by $103.3 billion or 152 percent—from a total of $68.1 billion in fiscal 1973 to $171.4 billion in fiscal 1983. At the same time, local taxes rose by $60.1 billion or 113 percent, from $53.0 billion in fiscal 1973 to $113.1 billion in fiscal 1983. As a result of these divergent growth rates, state collections rose from 56 percent of combined state-local taxes in 1973 to 60 percent in 1983.

State-local general taxes averaged $1,216 per capita in fiscal 1983—twice the $577 per capita level recorded for 1973. For this same period, though, state-local tax growth lagged behind increases in personal income. Nationwide, general taxes dropped from $129 per $1,000 of personal income to $111 per $1,000—down

(Continued on page 2)

New Flat Tax Proposals Would Reverse U.S. Policy According to New TF Study

The three leading plans for a modified flat income tax—the Treasury Department's November 1984 Report, the Bradley-Gephardt bill and the Kemp-Kasten bill—are analyzed in **"Flatter Taxes and Fatter Bases: An Evaluation of Current Proposals,"** a new special report from the Tax Foundation, Incorporated.

"There is much controversy over the economic impact of these tax reform plans," the 28-page report says, pointing out that all three would curtail severely the capital recovery provisions currently in effect.

The new study focuses principally on the Treasury Department's plan and weighs the two congressional proposals against the Treasury's concepts. Enactment of any of the proposals, it points out, would mark a "drastic reversal of the U.S. industrial tax policy put in place over the last year." The report also charges that Treasury's plan involves a deliberate shifting of the tax burden to the corporate sector.

Significant progress toward tax simplification, which the report defines as both "ease of compliance and for tax/investment planning," would be gained under Treasury's proposal. The price would be "the proposed spread of indexing and new measurements of income in the business sector."

Bradley-Gephardt and Kemp-Kasten offer somewhat less simplification but also contain fewer planning complications. "Both congressional programs are

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"State-local general taxes averaged $1,216 per capita in fiscal 1983—twice the $577 per capita level recorded for 1973."

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State-Local Tax Collections by State[a] Per Capita and Per $1,000 of Personal Income

Fiscal Years 1973 and 1983

State	Per capita taxes: Amount 1973	Amount 1983	Percent increase	Rank 1983	State-local taxes per $1,000 of personal income: Amount 1973	Amount 1983	Percent change	Rank 1983
U.S. Average	$577	$1,216	111	—	$129	$111	– 15	—
Alabama	351	806	129	48	104	94	– 10	44
Alaska	494	4,908	893	1	98	330	238	1
Arizona	557	1,064	91	32	138	108	– 22	23
Arkansas	342	771	125	50	105	92	– 12	46
California	739	1,337	81	13	149	108	– 27	24
Colorado	543	1,166	115	23	123	98	– 20	41
Connecticut	727	1,434	97	8	136	104	– 24	30
Delaware	586	1,273	117	16	115	109	– 5	21
Florida	491	968	97	38	119	90	– 24	50
Georgia	433	973	125	36	112	103	– 8	31
Hawaii	684	1,457	113	6	141	129	– 9	7
Idaho	447	875	96	47	121	99	– 18	40
Illinois	613	1,255	105	17	119	104	– 13	29
Indiana	470	905	93	44	108	90	– 16	49
Iowa	530	1,171	121	21	124	109	– 13	22
Kansas	517	1,129	118	26	117	97	– 18	42
Kentucky	404	888	120	45	113	101	– 11	37
Louisiana	449	1,051	134	33	128	105	– 19	28
Maine	514	1,082	110	31	142	121	– 15	11
Maryland	629	1,350	115	12	129	111	– 14	20
Massachusetts	714	1,425	100	10	148	118	– 20	14
Michigan	635	1,370	116	11	130	125	– 4	9
Minnesota	650	1,473	127	5	151	132	– 13	5
Mississippi	382	769	102	51	123	100	– 18	38
Missouri	473	931	97	41	110	92	– 17	47
Montana	527	1,179	124	20	132	126	– 5	8
Nebraska	503	1,146	128	24	117	108	– 7	25
Nevada	688	1,214	77	19	141	103	– 27	35
New Hampshire	454	951	110	40	110	89	– 19	51
New Jersey	631	1,457	131	7	120	112	– 7	19
New Mexico	438	1,041	138	34	128	117	– 9	15
New York	894	1,889	111	4	170	153	– 9	3
North Carolina	425	911	114	43	113	102	– 10	36
North Dakota	469	1,100	135	28	127	103	– 19	32
Ohio	475	1,100	131	29	104	103	– 2	33
Oklahoma	393	1,123	186	27	105	103	– 2	34
Oregon	533	1,229	131	18	127	119	– 6	13
Pennsylvania	581	1,169	101	22	130	107	– 18	26
Rhode Island	542	1,295	139	15	122	120	– 1	12
South Carolina	391	878	125	46	115	105	– 8	27
South Dakota	496	914	84	42	135	96	– 29	43
Tennessee	392	804	105	49	109	91	– 17	48
Texas	419	1,032	147	35	106	93	– 12	45
Utah	469	963	105	39	129	113	– 13	17
Vermont	618	1,138	84	25	168	122	– 28	10
Virginia	480	1,094	128	30	113	100	– 12	39
Washington	575	1,306	127	14	128	114	– 11	16
West Virginia	416	972	134	37	117	112	– 4	18
Wisconsin	664	1,425	114	9	158	132	– 16	6
Wyoming	534	2,443	357	2	126	202	60	2
District of Columbia	664	2,132	221	3	106	145	37	4

[a]Excludes unemployment taxes.
Source: U.S. Department of Commerce, Bureau of the Census; and Tax Foundation computations.

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(STATE-LOCAL TAX GROWTH, from page 1)

about 15 percent for the decade.

In 1983, 34 states and the District of Columbia had general taxes in excess of $1,000 per capita. Alaska ranked highest among the states in per capita state-local taxes ($4,908), followed by Wyoming ($2,443), the District of Columbia ($2,132), New York ($1,889), Minnesota ($1,473), Hawaii and New Jersey ($1,457), and Connecticut ($1,434).

The lowest taxes per capita in 1983 were recorded for Mississippi ($769), followed by Arkansas ($771), Tennessee ($804), Alabama ($806), and Idaho ($875).

Residents of Alaska also experienced the highest increase in collections per capita for the decade—almost a nine-fold advance. The next biggest proportionate increases occurred in Wyoming (357 percent), the District of Columbia (221 percent), Oklahoma (186 percent), Texas (147percent), Rhode Island (139 percent), and New Mexico (138 percent).

Nevada saw the smallest relative increase of any state—77 percent—followed by California (81 percent), and South Dakota and Vermont (84 percent).

In 1983, the highest state-local general tax burdens per $1,000 of personal income—next to Alaska's $330 high—were recorded for Wyoming ($202). New York ($153), the District of Columbia ($145), Minnesota and Wisconsin ($132), and Hawaii ($129).

Ranking lowest, by the same measure for 1983, were New Hampshire ($89), Florida and Indiana ($90), Tennessee ($91), and Missouri and Arkansas ($92).

Decreases in general state-local taxes in relation to personal income were recorded for the decade in 48 states. Of these, 9 showed declines of 20 percent or more. The most noteworthy of these were in South Dakota (a decrease of 29 percent), Vermont (28 percent), and California and Nevada (27 percent).

Increases in taxes relative to income for the decade were registered in Alaska (238 percent), Wyoming (60 percent), and the District of Columbia (37 percent).

The accompanying table provides further details.

(FLAT TAX STUDY, from page 1)

considerably more limited in the reach of their provisions," the report notes.

"The cost of investment capital probably would increase under all these plans," the report says. The full impact of Treasury's proposal is greatly dependent on future inflation rates and expectations as to future inflation.

"No present econometric framework can capture all the trade-offs and interactions of the proposed reforms," the study notes. "The net results for economic efficiency are unknown, and the attendant uncertainties about such a drastic change in industrial tax policy may lead to modification of the reform plans."

While Treasury emphasizes the neutrality of tax treatment between income groups of individuals and among industries and investments in its plan, this drive for "base-broadening neutrality" does not include the entry of political considerations into the proposal. The Tax Foundation analysis lists as political elements the doubling of the personal exemption and retaining of the basic mortgage interest deduction for individuals. It also cites a clash between neutrality and equity in such areas as the proposed elimination of deductions for state-local taxes and in the interaction be-

(Continued on page 4)

Property Taxes Stage Comeback in '83

Property taxes scored gains in the 9 percent range for the third consecutive year in fiscal year 1983, increasing by $7.3 billion over 1982 levels, according to analysis from the Tax Foundation.

These recent increases appear to have restored property tax trends to their pre-1978 pattern, which was drastically interrupted by California's Proposition 13, according to Tax Foundation economists. Prior to the California tax limitation, property taxes were growing at annual rates averaging 8.7 percent during the 1970s. Between 1977 and 1980, growth dropped to an annual rate of only about 3 percent—for a total three-year increase of less than $6 billion. From 1980 to 1983, property taxes grew by nearly 30 percent, or $21 billion.

Property tax growth in recent years has outpaced that of nonproperty taxes imposed by the states and localities. The difference was especially pronounced in 1983, when the 9.0 percent rise in property taxes was more than 50 percent faster than the 5.9 percent increase in nonproperty state and local levies.

The property tax is the main revenue source for local governments, providing 76 percent of all tax income. Although 43 states impose some type of property tax, the levies generally apply to a narrow base and furnish less than 2 percent of state tax revenues. More than 96 percent of combined state-local property tax revenues go to localities.

Over the past ten years property taxes almost doubled, rising by 97 percent from the $45.3 billion collected in 1973—an average annual rate of 7.0 percent. Per capita property tax revenues grew by 77 percent, from $216 in 1973 to $381 in 1983. During the same period property tax yields in relation to personal income dropped by 28 percent. *(Continued on page 4)*

"The property tax is the main revenue source for local governments, providing 76 percent of all tax income."

THE FRONT BURNER

By Robert C. Brown
President
Tax Foundation, Incorporated

"The Assault on Fringes"

Washington taxwriters are gearing up for another assault on fringe benefits. The various tax simplification proposals all address this question, and Senator Bob Packwood, new Chairman of the Senate Finance Committee, detects "a desire to eliminate employer-provided benefits."

This is an odd situation, given the corporate sector's proven ability to deliver an effective and efficient system of health, insurance and retirement benefits at no direct cost to government. But that's not the whole story.

Taxing fringes may parade in the sheep's clothing of equity and fairness, but it is a revenue grab, pure and simple. Treasury estimates that, in 1983, taxing benefits such as employer-paid health and dental insurance, child-care and pensions would have brought in an additional $70 billion. That's a pile of money, especially in view of Washington's inability to agree on how to cut a mere $50 billion from the bloated Federal budget for fiscal 1986.

The trouble with this debate is that so much of what is being said is either fallacious or irrelevant.

First off, the entire policy approach rests on the dubious foundation of tax expenditures. If you believe that everything you earn belongs to the government—except for that portion of your earnings Uncle Sam chooses not to take in taxes—then this is your cup of tea.

Secondly, the statistical arguments for this revenue heist indeed prove that you can validate any conclusion at all by manipulating the numbers. The argument runs that 30 to 40 percent of payroll is consumed by fringes. The fine print reveals that most of this is either legally mandated coverage for disability, social security, health and unemployment benefits or such traditional perks as pensions, group insurance, paid vacations, sick leave, and the like. The three basics—group life, group medical and pensions—comprise only about 12 percent to 14 percent of such payroll costs.

Finally, we are told that only the "fat cats" benefit from fringes. In fact, 90 percent of employees over 25 with one year of service are covered by health and life benefits; more than 70 percent have pension plans. In short, most "tax free" benefits accrue to the middle class. Indeed, they are one of the few breaks the U.S. worker receives in the tax code.

Maybe tax-exempt fringe benefits should be examined. Maybe all attempts to manipulate social policy through tax legislation need a second look. But let's approach the task honestly. Let's skip the self-righteous cant of fairness which is laid like a veneer over public-sector greed. And let's remove the debate from the current scramble for revenues to ward off the need to make politically painful budget cuts.

Tax action from 1982 to 1984 shows how much damage can be done to rational policy-making in the name of deficit reduction. Let's not repeat that mistake again this year.

"Taxing fringes may parade in the sheep's clothing of equity and fairness, but it is a revenue grab, pure and simple."

(PROPERTY TAXES, from page 3)

State-by-state trends in property taxes for the 1973-1983 period, both per capita and per $1,000 of personal income, appear in the table below, along with the 1983 rankings. Some highlights:

- On a per capita basis for 1983, Wyoming (with collections of $1,007 per person) and Alaska ($838) far outdistanced any other state. The next highest states were New Jersey ($635), Connecticut ($617), New York ($609), and New Hampshire ($604). Alabama ranked lowest in per capita property tax collections ($99), followed by New Mexico ($144), Louisiana ($147), Kentucky ($160), Arkansas ($162), and Mississippi ($165).
- In terms of the decade's percentage growth in per capita property taxes, Alaska and Wyoming also headed the list, followed by the District of Columbia, South Carolina, and Virginia. Altogether, 22 of the 51 jurisdictions reported a doubling or more in per capita property taxes for the decade. Reductions occurred only in Nevada (-.9 percent) and California (-.3 percent).
- Property taxes per $1,000 of state personal income were highest in Wyoming ($83), followed by Montana ($60), New Hampshire ($57), Alaska ($56), Michigan ($52), and Wisconsin and Rhode Island ($50). The lowest property tax burdens in relation to personal income were recorded for Alabama ($12), Louisiana ($15), Delaware and New Mexico ($16), Oklahoma ($17), and Kentucky ($18).
- Only five states and the District of Columbia showed any discernible growth in property taxes compared to personal income during the 1973-1983 period. They were: Alaska (up 127 percent), Wyoming (43 percent), the District of Columbia (31 percent), Michigan (8 percent), South Carolina (5 percent), and Rhode Island (2 percent). The sharpest reductions in the property tax to personal income ratio took place in California (down 60 percent), Nevada (59 percent), Massachusetts and Indiana (42 percent), South Dakota (41 percent), North Dakota (40 percent), Arizona and New Mexico (39 percent), and Oklahoma (38 percent).

Property Tax Collections by State Per Capita and Per $1,000 of Personal Income

Fiscal Years 1973 and 1983

State	Per capita property tax: Amount 1973	Amount 1983	Percent change	Rank 1983	Property taxes per $1,000 of personal income: Amount 1973	Amount 1983	Percent change	Rank 1983
U.S. Average	$216	$ 381	77	—	$48	$35	−28	—
Alabama	46	99	114	51	14	12	−16	51
Alaska	126	838	566	2	25	56	127	4
Arizona	211	316	49	31	52	32	−39	27
Arkansas	79	162	106	47	24	19	−20	45
California	348	347	(a)	27	70	28	−60	35
Colorado	218	408	87	21	49	34	−30	23
Connecticut	353	617	75	4	66	45	−32	14
Delaware	104	187	79	44	20	16	−22	49
Florida	143	332	132	28	35	31	−10	29
Georgia	126	266	111	36	33	28	−14	34
Hawaii	127	269	111	35	26	24	−10	40
Idaho	152	238	56	38	41	27	−34	36
Illinois	244	477	95	14	47	40	−17	19
Indiana	236	313	33	33	54	31	−42	28
Iowa	232	469	102	16	54	43	−20	15
Kansas	245	446	82	18	56	38	−31	20
Kentucky	78	160	105	48	22	18	−17	46
Louisiana	79	147	86	49	23	15	−35	50
Maine	223	409	84	20	62	46	−26	12
Maryland	196	354	80	26	40	29	−28	32
Massachusetts	358	523	46	12	74	43	−42	16
Michigan	234	571	144	8	48	52	8	5
Minnesota	221	413	87	19	51	37	−28	21
Mississippi	85	165	95	46	27	22	−21	42
Missouri	163	244	50	37	38	24	−37	38
Montana	267	560	110	9	67	60	−11	2
Nebraska	237	476	100	15	55	45	−19	13
Nevada	236	234	− 1	39	48	20	−59	44
New Hampshire	259	604	133	6	63	57	− 9	3
New Jersey	348	635	82	3	67	49	−27	10
New Mexico	91	144	59	50	26	16	−39	48
New York	320	609	90	5	61	49	−19	8
North Carolina	100	213	113	41	27	24	−11	39
North Dakota	183	318	74	30	50	30	−40	30
Ohio	186	355	91	25	41	33	−19	25
Oklahoma	104	189	81	43	28	17	−38	47
Oregon	255	507	98	13	61	49	−19	9
Pennsylvania	153	314	105	32	34	29	−16	33
Rhode Island	218	537	146	10	49	50	2	6
South Carolina	84	215	157	40	25	26	5	37
South Dakota	256	389	52	22	70	41	−41	17
Tennessee	103	206	100	42	29	23	−19	41
Texas	161	381	137	23	41	34	−16	22
Utah	146	281	92	34	40	33	−18	26
Vermont	236	452	91	17	64	48	−25	11
Virginia	130	324	149	29	31	30	− 3	31
Washington	198	379	91	24	44	33	−25	24
West Virginia	83	180	117	45	23	21	−11	43
Wisconsin	272	536	97	11	65	50	−23	7
Wyoming	247	1,007	307	1	58	83	43	1
District of Columbia	191	588	209	7	30	40	31	18

[a]Less than .05 percent.
Source: U.S. Department of Commerce, Bureau of the Census; and Tax Foundation computations.

(FLAT TAX STUDY, from page 2)

tween proposed treatment of capital gains and state income taxes.

On the doubling of the personal exemption, the report notes: "Raising the personal exemption to $2,000 would certainly be a popular attraction. It also has a weak link to neutrality of treatment and would be very expensive. Interestingly, of the myriads of revenue estimates provided by the Treasury for all kinds of changes from the breathtaking to the merely nit-picking, none is provided separately for the cost of doubling the personal exemption and increasing the zero bracket amount—even though these are among the easiest to estimate. Instead, their cost is lumped in with the effect of the marginal rate reductions totaling some $132 billion by 1990, of which the increased allowances must account for a substantial portion."

The fate of tax simplification in the 99th Congress remains "very much up for grabs," the report maintains. "It's far from certain that any such effort will be made even though there is a strong public interest in and desire for tax simplification and reform."

Those who seek to keep tax reform and deficit reduction on separate tracks "must succeed," the report argues, "for any real reform to have a chance."

"Flatter Taxes and Fatter Bases: An Evaluation of Current Proposals" is available from the Tax Foundation. See accompanying display box for details.

"Flatter Taxes and Fatter Bases: An Evaluation of Current Proposals," a Tax Foundation Special Report, 28 pp. 1985. Price: $7.50 members; $10.00 non-members; plus $1.00 postage and handling. Order from:

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TAX FOUNDATION'S VOL. 29, NO. 3 MARCH 1985

TAX·FEATURES

Tax Action in '82-'84 Has Halved Tax Cuts Promised for '85 by ERTA

Federal tax law changes taking effect since 1981 have pared the tax cuts promised for 1985 by the Economic Recovery Tax Act of 1981 (ERTA) to about half their original size, according to Tax Foundation analysis.

Under the tax rates and structure in effect on January 1, 1981, Federal receipts in fiscal year 1985 would have amounted to $821.3 billion. ERTA reduced that by $168.5 billion, just over 20 percent. Because of other legislation, however, actual receipts are now estimated at $736.9 billion, a reduction of only 10 percent from what the pre-1981 tax structure would have yielded. Instead of $168.5 billion in savings offered by ERTA, net tax savings will be $84.4 billion—half as much.

These revenue changes mirror the effects of the seven major tax bills enacted from 1981 through 1984, together with increases in social security taxes scheduled under pre-1981 legislation.

ERTA's main provisions reduced 1985 individual income taxes by 132.8 billion (including savings incentives), corporate income taxes by $31.1 billion, and estate and gift taxes by $4.7 billion at 1985 levels of economic activity.

The Tax Equity and Fiscal Responsibility Act of 1982 (TEFRA) took back $40.7 billion of the intended 1985 cuts under ERTA by a series of measures tightening up on compliance and collection, removing "unintended benefits and obsolete incentives," and raising excise taxes and employment levies. TEFRA added $12.4 billion to 1985 individual income tax burdens, $19.3 billion to corporate income taxes, $5.4 billion to excise

(Continued on page 6)

Comparison of Estimated 1985 Federal Tax Receipts under Tax Rates and Structure in Effect on January 1, 1981 and January 1, 1985

	Billions
1985 receipts under January 1, 1981 tax rates and structure	$ 821.3
1985 receipts under January 1, 1985 tax rates and structure	736.9
Net reduction due to changes in law	– 84.4
Statutory basis for change:	
Economic Recovery Tax Act of 1981	– 168.5
Tax Equity and Fiscal Responsibility Act of 1982	+ 40.7
Highway Revenue Act of 1982	+ 4.4
Social Security Amendments of 1983	+ 9.3
Interest and Dividends Compliance Act of 1983	– 2.4
Railroad Retirement Act of 1983	+ 0.7
Deficit Reduction Act of 1984	+ 9.3
Automatic increases in social security tax base under prior law[a]	+ 12.0
Increases in social security tax rate under prior law[b]	+ 10.0
Exhibit: ERTA effects	– 168.5
Net increases, 1982-1984	+ 84.1
Net reduction 1981-1985	– 84.4

[a]January 1 of 1982, 1983, 1984, and 1985.
[b]January 1 of 1982, 1984, and 1985—less amount attributed to 1983 social security law above.
Source: Office of Management and Budget.

Sales Tax Revenues Single Biggest Source Of Funds for States

Sales taxes are the single most productive revenue raisers for state governments, according to recent analysis by the Tax Foundation, Incorporated. Economists at the Washington-based tax watchdog organization say that general sales taxes, which are levied by 45 states, brought in $53.6 billion to state treasuries in fiscal year 1983—nearly one-third (31.3 percent) of all state tax collections that year.

Connecticut led the list for top rates with its 7.5 percent sales and use tax rate, followed by: Washington (6.5 percent); Minnesota, Mississippi, New Jersey, Pennsylvania, and Rhode Island (6 percent); and Nevada (5.75 percent). No state general sales tax is levied in Alaska, Delaware, Montana, New Hampshire, or Oregon, although municipalities in Alaska do impose sales tax.

Lowest State Sales Taxes

The lowest state sales tax rate of 3 percent is levied in seven states: Colorado, Georgia, Kansas, North Carolina, Oklahoma, Virginia, and Wyoming. (Oklahoma's sales tax will revert to 2 percent on January 1, 1986.) Localities in 29 states levy sales taxes, generally in addition to those shown in the accompanying table. New York City and Yonkers, New York, with a combined state-local rate of 8.25 percent are the highest in the nation.

(Continued on page 2)

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"Sales taxes are the single most productive revenue raisers for state governments."

(SALES TAX REVENUES, from page 1)

Personal income taxes ranked second as revenue raisers, bringing in $49.8 billion in fiscal 1983 for 29.1 percent of total tax receipts. Corporate income taxes, the third largest single tax source, amounted to $13.2 billion, 7.7 percent of the total. Only five states (Nevada, South Dakota, Texas, Washington, and Wyoming) have neither a corporate nor a personal income tax, and only seven states (the previous five plus Alaska and Florida) have no individual income tax.

Major Taxes and Rates Used by States
As of January 1, 1985

State	Income taxes: Corporation	Income taxes: Individual	General sales and use tax	Gasoline tax (per gallon)	Cigarette tax (per pack of 20)	Property tax
Alabama	5% (F)	2 to 5% (F)	4%[a]	11¢	16.5¢	X
Arizona	2.5 to 10.5 (F)	2 to 8 (F)	5[a]	13	15	X
Arkansas	1 to 6	1 to 7	4[a]	9.5	21	X
California	9.6	1 to 11	4.75[a]	9	10	X
Colorado	5[b]	3 to 8 (F)	3[a]	12	15[b]	X
Connecticut	11.5[c]	6 to 13[d]	7.5	15[e]	26	X
Georgia	6	1 to 6	3[a]	7.5 + 3% of retail	12	X
Hawaii	5.85 to 6.435	2.25 to 11	4	12.5 to 16	40% wholesale	
Idaho	7.7	2 to 7.5	4	14.5	9.1	X
Illinois	4	2.5	5[a]	12[e]	12	X
Indiana	3[f]	3	5	11.1	10.5	X
Iowa	6 to 12 (F)	.5 to 13 (F)	4	13	18	
Kansas	4.5[g]	2 to 9 (F[h])	3[a]	11	16	X
Kentucky	3 to 6	2 to 6 (F[h])	5[a]	10[i]	3	X
Louisiana	4 to 8 (F)	2 to 6 (F)	4[a]	16	16	X
Maine	3.5 to 8.93	1 to 10	5	14	20[e]	X
Maryland	7	2 to 5	5	13.5[i]	13	X
Massachusetts	8.33[i]	5[k]	5	11	26	X
Michigan	2.35	5.35[b]	4	15	21	X
Minnesota	6 to 12	1.6 to 16 (F)	6[a]	17	18	X
Mississippi	3 to 5	3 to 5	6	9	11	X
Missouri	5 (F)	1.5 to 6 (F)	4.125[a,e]	7	13	X
Nebraska	4.75 to 6.65	19% of Federal income tax	3.5[a]	14.9	18	X
New Jersey	9[l]	2 to 3.5	6	8	25	X
New Mexico	4.8 to 7.2	.7 to 7.8[m]	3.75[a]	11	12	X
New York	10[c]	2 to 14	4[a]	8	21[b]	
North Carolina	6	3 to 7	3[a]	12	2	X
North Dakota	3 to 10.5 (F)	2 to 9[b,n] (F)	4	13	18	X
Ohio	5.1 to 9.2	.95 to 9.5	5[a]	12	14	X
Oklahoma	4	.5 to 6[m] (F)	3[a,b]	9	18	
Pennsylvania	9.5	2.35	6[a]	12	18	X
Rhode Island	8[i]	24.9% of Federal income tax	6	13[i]	23	X
South Carolina	6	2 to 7 (F)	5	13	7	X
Tennessee	6	6[d]	5.5[a,b]	9	13	
Utah	5	2.25 to 7.75 (F)	4.625[a,b]	14	12	X
Vermont	6 to 9[b]	26.5% of Federal income tax	4[b]	13	17	X
Virginia	6	2 to 5.75	3[a]	11	2.5	X
West Virginia	6 to 7[o]	2.1 to 13	5	10.5	17	X
Wisconsin	7.9	3.4 to 7	5[a]	16	25	X
Florida	5		5[a]	4	21	X
Nevada	These 5 states have no corporate income tax	These 7 states have no individual income tax	5.75[a]	10.25	15[b]	X
South Dakota			4[a]	13	15	
Texas			4.125[a]	10	19.5[e]	
Washington			6.5[a]	18	23	X
Wyoming			3[a]	8	8	X
Alaska	1 to 9.4		These 5 states have no general sales tax	8	8	X
Delaware	8.7	1.3 to 10.7 (F)		11	14	
Montana	6.75[m]	2 to 11 (F)		15	16	X
New Hampshire	8[p]	5[d]		14	17	X
Oregon	7.5	4 to 10 (F)		10	19[b]	X

(X) Indicates state levies a property tax.
(F) Allows Federal income tax as a deduction.

[a] Local taxes are additional.
[b] Future reduction scheduled under current law.
[c] Alternative methods of calculation may be required.
[d] In Connecticut, New Hampshire, and Tennessee, tax applies to income from intangibles only, at various rates according to type.
[e] Future increases scheduled under current law.
[f] Tax is 3% of adjusted gross income. A supplemental net income tax is imposed at 4%.
[g] A 2¼% surtax is imposed on taxable income in excess of $25,000.
[h] Deductions limited.
[i] Tax imposed at percent of wholesale value.
[j] Additional 14% surtax is imposed.
[k] Tax of 10% on income derived from intangibles, and 5% on all other income, and an additional 7.5% tax.
[l] Additional tax on net worth is part of the corporate franchise tax.
[m] Qualified taxpayers may elect to pay alternative taxes at varying rates.
[n] Optional tax of 7.5% of taxpayer's adjusted Federal income tax liability.
[o] From January 1, 1983 through June 30, 1985, a 15% surtax is imposed.
[p] Surtax of 13.5% is imposed.
Source: Compiled by Tax Foundation from data reported by Commerce Clearing House.

Top Individual Rates

Top individual rates prevail in Minnesota (16 percent); New York (14 percent); Connecticut (on a limited base), Iowa, and West Virginia (13 percent). Income tax rate schedules are progressive (i.e., rise as income brackets go up) in all but five states. Illinois, Indiana, Massachusetts, Michigan, and Pennsylvania apply a flat rate, regardless of income level. In three states, income taxes are levied as a percentage of Federal individual income tax obligations—Nebraska, Rhode Island, and Vermont. The maximum corporate income tax rates are highest in Iowa and Minnesota (12 percent); Connecticut (11.5 percent); Arizona and North Dakota (10.5 percent); and New York (10 percent).

Gasoline Taxes

All 50 states tax gasoline, with the highest rates prevailing in Washington (18 cents); Minnesota (17 cents); Louisiana and Wisconsin (16 cents); Connecticut, Michigan, and Montana (15 cents); and Hawaii (where combined state-local rates range from 12.5 to 16 cents per gallon). Florida (4 cents); Missouri (7 cents); Alaska, New Jersey, New York, and Wyoming (8 cents) place the lowest levies on gasoline. The motor fuels taxes in Georgia, Kentucky, Maryland, and Rhode Island are levied at specific percentages of the wholesale or retail selling price of the product. In addition, some states also tax motor fuels under the states' general sales tax. In fiscal 1983, the states collected $10.8 billion, 6.3 percent of their total taxes, from motor fuel levies.

Cigarette taxes are another important source of state tax revenues. In fiscal 1983, the states collected $4.0 billion, 2.3 percent of their total taxes, from tobacco products excises.

All states have local property taxes, and 43 have state property taxes; 39 states have both general sales and income taxes; and 32 states have general sales, income, and property taxes.

The accompanying table gives further details, as of January 1, 1985, for major taxes and rates prevailing in the states.

MARK YOUR CALENDAR

Tax Foundation's **37th National Conference** and **48th Annual Dinner** will be held this year on **Wednesday, December 4, 1985,** at a new location—the **Waldorf-Astoria Hotel** in New York City. Details will be announced in future issues of *Tax Features*.

Fringe Benefits Loom as Major Target For Revenue Hungry Uncle Sam in 1985

A new act is starting in a long-running tax melodrama starring the Internal Revenue Service in hot pursuit of fringe benefits—those employer contributions to pensions, medical and insurance plans, free parking, company cars, employee discounts and dozens of other supplements to cash pay that have largely escaped the Federal income tax up to now. Free tickets from airlines' "Frequent Flyers" programs are the latest IRS target.

As this report went to press in the Spring of 1985, legislation aimed at taxing still more benefits was beginning to move through the legislative process in Congress. The general opinion was that fringe benefits increasingly will be subjected to income tax as time goes on. But that is not a certainty. Opinion polls show a large majority of voters oppose taxing of benefits, with many preferring higher income tax rates over taxes on fringes—if that choice has to be made.

Billions at Stake

Multi-billions of dollars are at stake in this issue, and anyone who cares about his/her Federal tax burden should be aware that taxation of fringes can turn into a tax collector's dream and a taxpayer's nightmare in the late 1980s and 1990s. One reason is that if the "fair market value" of a benefit such as free parking becomes subject to income tax, that amount of value would then be subject also to social security and unemployment taxes, Federal income tax withholding and probably state and local income taxes.

The chart below hints at the other side of the story, the need to "protect the revenue base" as government tax experts put it. The record is clear that fringe benefits have proliferated far beyond anyone's expectation. The U.S. Treasury and its tax collecting arm, the IRS, fear that more and more compensation for workers and executives will be designed as fringe benefits in the years ahead, thus reducing the dollars subject to income tax and social security/unemployment tax, thereby shrinking the revenue available for supporting general government including social security. For example, excluding health and pension contributions for taxable income lowers income tax collections an estimated $80 billion a year.

History shows the benefits-tax issue has been a dilemma for Congress and tax collectors from the earliest days of the modern income tax. But it was only after income tax rates zoomed to a top of 90 percent for a while in World War II that fringes really flowered. Big unions joined in the flight away from taxable income into nontaxable forms of compensation. Demands for fringes became as important as cash wage increases in labor contract negotiations. Executive perks blossomed, with tax-deferred compensation the centerpiece. And Congress led the parade in seeing to it that its Members, their staffs, and other Federal employees got their share of untaxed pay.

Taxing Social Security Benefits

Now a rollback in the tide of tax-free or tax-deferred income is well underway. One significant move came in Spring, 1983, when—in the name of a fiscal rescue for a nearly insolvent social security system—Congress applied the income tax to part of the benefits received by social security pensioners whose total incomes are above $25,000 for singles, $32,000 for a married couple, starting in 1984.

Social security benefits are not usually thought of as "fringes" since the system is supported by increasingly heavy payroll taxes on both employers and employees. But the tax-free status of those benefits from their beginning in the late 1930s until 1983 was the leading example of income (in the form of social security benefits) resulting from personal services that had been protected from the income tax. Partial withdrawal of that protection beginning in 1984 showed the trend to "broadening the revenue base" which has become the rallying cry for "tax reform" in the 1980s.

(Continued on page 4)

"Anyone who cares about his/her Federal tax burden should be aware that taxation of fringes can turn into a tax collector's dream and a taxpayer's nightmare in the 1980s and 1990s."

The Flowering of Fringes

Nobody knows the value in current dollars of all fringe benefits now built into the U.S. pay system. But the upward trend can be seen in the growth of four major fringes—

	Employer contributions (millions of $)				Percentage of all wages and salaries			
	1952	1962	1972	1983	1952	1962	1972	1983
Pensions and profit sharing	$2,543	$5,442	$17,903	$64,821	1.7%	2.3%	3.6%	4.9%
Group health insurance . . .	1,115	4,188	16,163	81,999	0.7%	1.7%	3.2%	6.2%
Group life insurance	361	1,219	3,573	7,592	0.2%	0.5%	0.7%	0.6%
Workmen's-compensation insurance	1,030	1,745	4,406	15,878	0.7%	0.7%	0.9%	1.2%
TOTAL	$5,049	$12,594	$42,045	$170,290	3.3%	5.2%	8.5%	12.8%

Note: Data for private sector. Government employees are covered by separate pay and fringes systems.
Source: U.S. Dept. of Commerce, *National Income and Product Accounts, 1929-76 Statistical Tables*, September, 1981; *Survey of Current Business*, July, 1984.

(FRINGE BENEFITS, *from page 3*)

Targets for '85

At the time of this report, in early Spring, 1985, Congress was just beginning what promised to be a long and heated battle over virtually all tax policies, including fringe benefit issues.

The Treasury Department's Tax Reform Report to the President, issued in November 1984, was the kickoff. It proposed a simplified tax setup featuring fewer and lower income tax rates with fewer deductions and credits.

On fringes, the Treasury proposed a cap of $70 a month for singles, $175 for families, on tax-free premiums paid by employers for health insurance benefits; repeal of tax exclusion for group term life insurance (already taxable above $50,000 policy amount) and unemployment pay (now taxable when income exceeds $18,000 for joint returns, $12,000 for singles); repeal of special tax breaks for education benefits, legal services, dependent care, "cafeteria" plans (flexible benefits chosen by employees from a menu offered by their employers).

Other tax reform measures before Congress would wipe out tax protection for most benefits or reduce the limit on the amount sheltered from tax. The Bradley-Gephardt "flat" tax plan would tax employer-paid health and life insurance premiums as income, and lower the limits on tax-deferred pension contributions and benefits by one-third. The Kemp-Kasten "fair" plan leaves pensions, health and life insurance benefits in place but taxes others, including social security payments.

Uncertain Outcome

What Congress actually will do is uncertain. One possibility is an overall limit, or cap, on the value of the total benefits that can be tax-free for any one person. A pressing practical dilemma is how to measure, fairly and accurately, the market value of many benefits such as commuting (van pooling) aid and child care help, for instance.

Writing statutory language to accomplish that is a daunting task. The alternative is to leave it to the IRS to determine, through its regulations and the often arbitrary decisions of individual agents, what is "qualified" for tax favors and what the "fair market value" of a benefit should be. If that alternative is adopted, as it probably will be, the confusion, uncertainty and frequent unfairness that has marked tax administration in the fringe benefits area will continue apace—as it has for more than 70 years.

"What Congress actually will do is uncertain. One possibility is an overall limit, or cap, on the value of the total benefits that can be tax-free for any one person."

Tax Collectors vs Fringe Benefits: A 70-Year Chase

In the Beginning . . .

Congress adopted the income tax in September, 1913, imposing a 1 percent base tax on taxable income above $4,000 a year plus an additional tax starting at 1 percent on $20,000 and progressing up to the maximum of 6 percent on income over $500,000. The tax applied to "gains, profits, and income derived from salaries, wages, or compensation for personal services . . . derived from any source. . . ."

"Include Me Out . . ."

Scrambling to avoid the tax began at once. A constitutional challenge was settled when the Supreme Court held the tax had been authorized by the 16th Amendment, ratified in February 1913. But court and congressional wrangles over income tax details have never stopped, often centering on disputes over the exact definition of "income subject to tax." Noncash compensation, now called fringe benefits, raised its head early in the tax chase, and the Internal Revenue Service of that period gave its blessing to the idea that some forms of compensation were nontaxable—much to the regret of later tax collectors.

The Grandfathers . . .

The first of all fringe benefits apparently was reimbursement for supper when paid to an employee working overtime for the convenience of the employer. That was ruled to be "not income" for tax purposes by the IRS in 1920. In 1921, railroad passes issued to railroad employees were determined by the IRS to be "gifts" and thus not taxable income. The modern descendants of those first fringes now include free parking at the workplace, airline and bus passes to employees, subsidized cafeterias, daycare centers, recreational facilities, free trips to conventions for workers and their families, price discounts, company cars and trucks, free financial counseling and legal services, etc., etc. As benefits multiplied, so did confusion over their tax status. New laws from Congress, new regulations from the IRS, flowed out of Washington in an unending stream. IRS agents applied the laws and rules with baffling inconsistency. Courts frequently disagreed with the IRS, and each other.

Statutory Exemptions. . .

Rising controversy led to adoption of the first Internal Revenue Code in 1939, restating and cleaning up the body of tax law developed up to then. A revised Code was adopted in 1954, reflecting changes since 1939. Section 61 of the Code provides that gross income includes income in any form, and the Supreme Court

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Tax Features

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Localities Outpace States and Washington In Raising Own-Source Tax/Nontax Revenues

Local government is a growth industry, if recent trends in both tax and nontax revenue raised by the localities mean anything. Recent analysis by Tax Foundation economists shows that such revenues jumped nearly 10 percent from fiscal 1982 to fiscal 1983, an increase of $15.9 billion, and a total income of $179.1 billion. Fiscal 1983 also marked the fourth consecutive year that localities increased the share of total general revenues raised from their own sources, according to analysts at the Washington-based tax watchdog organization.

The rise in local own-source revenues far outpaced increases in similar categories of revenue at both the Federal and state levels. Fiscal 1983 own-source general revenues of the states rose by about 6 percent ($11.8 billion), while Federal general revenue collections actually dropped by $14.1 billion (about 3 percent).

Of total local general revenue from all sources totaling $298.5 billion in 1983, 60 percent came from local sources. This share was up from 58.5 percent in 1982 and was higher than in any year since 1973, when Federal general revenue sharing became effective.

As a share of local general revenue, Federal and state financial aid peaked at 44.7 percent in 1979. At that time, this aid totaled $94.8 billion. Although intergovernmental grants grew by $24.6 billion (26 percent) between 1979 and 1983, to a total of $119.4 billion, locally raised revenue jumped by $61.9 billion (53 percent) at the same time.

The Federal contribution to local government rose sharply during the 1970s, reaching a high of 10 percent of local general revenue in 1978. This share has fallen in each year since, to a level of 7.0 percent in 1983. Although the dollar amount of Federal aid to localities rose slightly in 1983 from the previous year, it was still $1.4 billion below its high of $22.4 billion in fiscal 1981.

State aid to local units since 1970 has ranged between 33.0 and 35.0 percent of local general revenues. Fiscal 1983 state aid of $98.4 billion represented 33.0 percent of local revenue, down from 35.0 percent in 1979 and 1980, and the lowest percentage since 1968.

On balance, despite fluctuations during the decade, local governments in fiscal 1983 were raising about the same share of their budgets as they had in 1973, according to Tax Foundation analysts. But a major shift occurred in the tax versus nontax mix of the funds. The share of local revenue coming from local taxes dropped from 44.8 percent in 1973 to 37.9 percent in 1983. Nontaxes—charges and miscellaneous general revenues—moved up from 14.7 percent to 22.1 percent of the total.

In dollar amounts, local taxes rose from $53.0 billion in 1973 to $113.1 billion in 1983, a 113 percent rise. At the same time, nontax revenues grew from $17.5 billion to $66.0 billion, or 278 percent.

In fiscal year 1983, for every dollar raised by local units in taxes, 58 cents was raised in nontax general revenues; this share was up from 33 cents ten years earlier.

The major elements of the nontax revenues that have led to these effects are current charges for goods and services provided to users and interest earnings on financial assets held by local governments.

Current charges rose from $12.3 billion in 1973 to $39.4 billion in 1983, more than tripling. For every tax dollar raised in 1973, current charges produced 23 cents; by 1983 it was 35 cents. (For local governments, current charges come from a variety of fees and charges such as school lunch sales, college tuition, hospital charges, sewerage and sanitation fees, parks and recreation, air transportation, housing and urban renewal receipts, and others.)

Other nontax general revenue, labeled "miscellaneous general revenue," totaled $26.6 billion in 1983, over five times the $5.2 billion coming from such sources in 1973. These include receipts from special assessments, sales of property, interest earnings and other sources. A significant factor in the decade's rise was interest earnings on cash and security holdings of local governments. These earnings came to $13.9 billion in fiscal 1983, more than seven times the $1.9 billion earned ten years earlier. The rise is due both to general increases in interest rates over the decade, as well as to larger financial holdings of local jurisdictions, according to Tax Foundation analysts. Yields on top grade corporate bonds, for example, rose from an average of 7.44 percent in 1973 to 12.04 percent in 1983 (more than 60 percent). At the same time, cash and security holdings of states and localities (excluding the substantial amounts held for insurance trust programs such as employee retirement and unemployment compensation) rose from $47.9 billion to $134.9 billion at the end of fiscal 1983. (Separate figures on asset holdings are not available for local governments alone.)

In every year since 1972 local units as a whole have experienced surpluses on their general accounts, as

(Continued on page 6)

"Fiscal 1983 marked the fourth consecutive year that localities increased the share of total general revenues raised from their own sources."

Currently Available

"Flatter Taxes and Fatter Bases: An Evaluation of Current Proposals," Special Report, 28 pp., $10.00 ($7.50 members).

"State Income Taxation of Multinational Corporations," Proceedings of a Tax Foundation Seminar, May 1984, 35 pp., $15.00 ($12.00 members).

"State Taxation and Business Climate," Research Bibliography No. 71, February 1985, 10 pp., $4.00.

"At Issue: Is Corporate Investment Income Taxed Too Lightly?" by Jack F. Bennett, Fiscal Policy Forum, Winter 1985, 4 pp., $1.00.

"At Issue: Taxpayers vs. Tax Spenders—Who's Less Honest?," by Leif H. Olsen, Fiscal Policy Forum, Fall 1984, 6 pp., $1.00.

"At Issue: Tax Compliance," by Duane R. Kullberg and Roscoe L. Egger, Jr., Fiscal Policy Forum, Spring 1984, 8 pp., $1.00.

"Expenditure Control: The True Road to Tax Reform," Murray L. Weidenbaum, January 1985, 4 pp., $1.00.

(Plus $1.00 postage and handling on all orders.)

Percentage Distribution of Local General Revenue by Source
Selected Fiscal Years 1902-1983

Year	Amount[a] (millions)	Percent of Total: From own sources: Total	Taxes: Total	Taxes: Property	Taxes: Other	Charges and miscellaneous	Intergovernmental: From state	Intergovernmental: From Federal government
1902	$ 854	93.4	82.4	73.1	9.3	11.0	6.1	.5
1913	1,637	94.1	79.9	72.8	7.1	14.2	5.6	.4
1922	3,866	91.7	79.4	76.9	2.5	12.3	8.1	.2
1932	5,690	85.7	75.1	73.1	2.0	10.6	14.1	.2
1940	6,939	72.2	64.8	60.1	4.7	7.3	23.8	4.0
1950	14,014	68.4	57.0	50.2	6.8	11.4	30.1	1.5
1960	33,026	69.4	54.7	47.8	6.9	14.6	28.8	1.8
1965	47,527	68.1	52.8	45.9	6.9	15.2	29.5	2.4
1969	71,943	63.7	48.3	41.3	7.0	15.4	33.1	3.1
1970	80,917	63.5	48.0	40.7	7.3	15.5	33.3	3.2
1971	91,963	62.5	47.2	39.9	7.3	15.3	33.8	3.7
1972	105,243	62.3	47.3	39.5	7.8	15.0	33.4	4.3
1973	118,392	59.6	44.8	37.1	7.7	14.8	33.8	6.7
1974	131,434	58.4	43.0	35.3	7.7	15.4	33.9	7.8
1975	146,307	57.7	41.9	34.2	7.7	15.7	34.9	7.4
1976	162,931	57.2	41.5	33.7	7.8	15.7	34.5	8.3
1977	179,045	57.1	41.8	33.7	8.1	15.3	33.7	9.2
1978	194,784	56.8	41.3	32.9	8.4	15.6	33.2	10.0
1979	211,987	55.3	38.0	29.5	8.5	17.3	35.0	9.7
1980	232,452	55.9	37.2	28.2	9.0	18.8	35.0	9.1
1981	257,180	56.7	36.9	28.0	8.9	19.8	34.6	8.7
1982	279,203	58.5	37.1	28.2	8.9	21.3	34.0	7.5
1983	278,542	60.0	37.9	28.8	9.1	22.1	33.0	7.0

[a]General revenue represents total revenue less utility, liquor store, and insurance trust revenue.
Source: Department of Commerce, Bureau of the Census; percentage computations by Tax Foundation.

(LOCAL REVENUES, from page 5)

measured by the Bureau of the Census. In 1983, general revenues of all local jurisdictions totaled $298.5 billion, or $14.6 billion more than general spending of $283.9 billion. While local units generally have requirements that operating budgets be in balance, capital projects are typically financed separately, by long-term bond issues, and there is no requirement for the matching of annual revenue and outlay of capital budgets. In fact, throughout the 1950s and 1960s, and until 1973—when Federal general revenue sharing began—local government general spending exceeded general revenues in each year.

These observations are based on totals for some 82,000 local jurisdictions, nearly 66,000 of which have property-taxing powers. General financial surpluses shown as totals may obscure varying conditions among individual jurisdictions, say Tax Foundation economists. However, 1983 general revenues exceeded general spending in each category of jurisdictions—counties, municipalities, townships, special districts, and school districts—and in all but eight states.

The table above provides further details.

New Publication

"State Taxation and Business Climate," Research Bibliography No. 71, has just been issued by the Tax Foundation. A selective bibliography of resources available, it is divided into four sections: Business Climate Ranking Studies, Business Location Decisions, Taxation and Business Climate, and Interjurisdictional Tax Comparisons. 10 pp. $4.00, plus $1.00 postage and handling.

(ERTA TAX CUTS, from page 1)

taxes, and $3.5 billion to social insurance contributions (largely employer payroll taxes).

The Highway Revenue Act of 1982 added $4.4 billion to 1985 receipts by raising the tax on gasoline and motor fuels by 5 cents a gallon, and hiking some highway user fees.

In 1983, the Social Security Amendments and the Railroad Retirement Revenue Act boosted 1985 social insurance taxes by a total of $10.3 billion (with some offsets in individual income taxes). Other 1983 legislation operated in reverse, reducing taxes by about $2.4 billion by repealing the withholding of interest and dividends that had been scheduled under TEFRA.

The tax-increasing mood again prevailed in Congress last year, when it approved the Deficit Reduction Act of 1984, raising 1985 taxes by $9.3 billion, primarily by boosting individual income taxes by $5.6 billion and

(Continued on page 7)

Conferences Planned

Tax policy conferences under Tax Foundation sponsorship are being planned for the following dates:

Tuesday, June 4, 1985
Washington D.C.

Tuesday, September 10, 1985
Atlanta, GA

Details of the program and speakers will be announced in future issues of *Tax Features*, or contact:

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(ERTA TAX CUTS, from page 6)

corporate profits taxes by $3.3 billion.

Additionally, there were social security tax increases totaling $22.0 billion as a result of four automatic annual increases in the indexed maximum social security base and pre-1981 legislation that had scheduled future social security tax rate hikes.

On balance, individual income taxpayers fared better than corporate payers in the 1982-84 changes. Individual payers in 1985 are getting a cut from pre-ERTA levels of $117.0 billion—only 12 percent less than the amount provided by ERTA. For corporate payers, the actual reduction from pre-1981 amounts will be only $10.5 billion—66 percent less than originally offered by ERTA. Both individuals and corporations will share the added $31.9 billion in social insurance contributions resulting from changes in tax rates and structure during the 1981-1985 period.

Despite the reductions resulting from tax legislation, expansion of the economic base will raise actual Federal receipts in fiscal 1985 about $220 billion or 42 percent above 1980 collections. Social insurance contributions, which rose 70 percent in the five-year period, account for 50 percent of the 1980-1985 total dollar increase. Individual income taxes, rising 35 percent, made up 39 percent of the aggregate dollar rise in Federal receipts. All other categories of receipts showed smaller gains, with the exception of estate and gift taxes, which are estimated to be about 12 percent less in 1985 than in 1980.

THE FRONT BURNER

By Robert C. Brown
President
Tax Foundation, Incorporated

"Gimme Shelter"

The numbers vary, depending on the source of the data, the mechanism of tax avoidance, the methods used to calculate tax payments, and other variables. But one thing is clear. Tax shelters are big business.

A tax shelter usually has these components: large deductions now for depreciation and interest, and deferred taxes on earnings, with possible capital gains treatment for those receipts at the end of the investment. What's so terrible about that? Why such bad press for a device that simply allows Americans to keep more of what they earn?

Within certain limits, we're all for tax shelters. While everyone accepts the need to shoulder our share of public costs, no one wants to pay more than the law absolutely requires. Having said that, there are a number of worrisome aspects to the tax shelter bonanza that has turned this field into a growth industry in recent years. They deserve at least a passing glance from every thoughtful American.

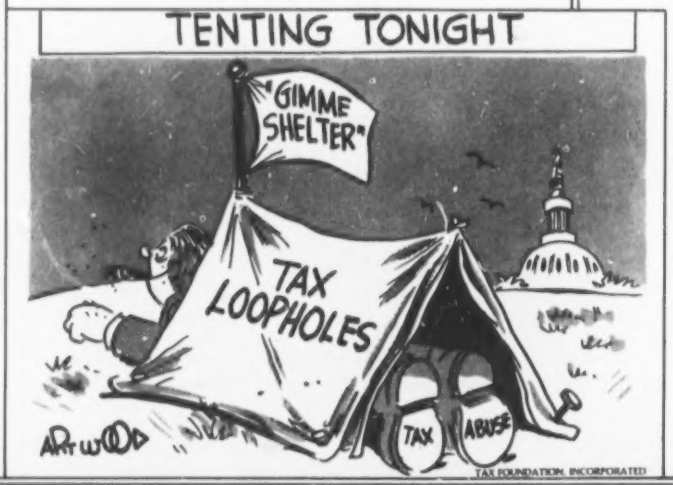
- The spread of tax shelters has led to investment decisions driven by tax considerations, rather than by economic or business goals. This does not help American productivity or competitiveness in world markets.
- Marginally productive—or nonproductive—tax shelters like jojoba bean farms or commodity tax straddles divert needed capital resources into inefficient channels, distorting the true interplay of market forces in the economy. One result is the present nationwide glut of commercial office space.
- Sheltering billions of dollars of potentially taxable income—$35 billion in partnership "losses" alone in 1983—seriously reduces the revenue pool available to Uncle Sam.
- This narrowing of the tax base raises taxes for those without sheltered income.
- A great deal of legal, accounting and marketing talent diverts from productive involvement into the highly lucrative areas of devising and running tax shelters.
- The unsophisticated are lured into tax-avoidance schemes of questionable legality and wind up not only losing the shelter but paying penalties for trying to beat the tax collector. Of the 1.2 million returns audited in fiscal 1984, the IRS reports that 100,000 involved abusive tax shelter investments, with an average assessment for back taxes and penalties totaling $19,000.

The Administration and Congress are now seeking ways to close the gap between Federal revenues and outlays. They should take a good look at tax shelters. Loophole closing and stiffer enforcement in this area would bolster revenues significantly.

Even more important than the dollars and cents involved, however, is a consideration touched on recently by IRS Commissioner Roscoe L. Egger. "People resent a system which gives special privileges to a few," he cautioned, "making it more costly and tougher on everybody else." If our system of public finance is not to collapse under the combined weight of distrust, disrespect and disparity, we had better heed the Commissioner's warning.

In one area that will both broaden the base and increase fairness—doing away with overuse and abuse of tax shelters—it is time for the train to leave the station.

"The spread of tax shelters has led to investment decisions driven by tax considerations, rather than by economic or business goals. This does not help American productivity or competitiveness in world markets."



(FRINGE BENEFITS, from page 4)

has interpreted this Section to mean that "all accessions to wealth" are subject to tax unless specifically exempted. This decision, in 1961, laid the legal base for the present drive to tighten the tax net on fringes, because Congress so far has given statutory exemption to a fairly short list of benefits. The most important are employer contributions to pension, health and disability plans; group life insurance up to $50,000; group legal services; meals, lodging and transportation furnished for the employer's convenience; employer's van-pool commuting; parsonage allowance, scholarships and housing aid for employees of educational institutions and their dependents; employer-provided child and other dependent care aid.

"The real bite in the 1984 law will come when the IRS regulations are written and enforced."

A Drive Begins . . .

In the mid-1970s, the U.S. Treasury and IRS began a joint campaign to impose taxes on the growing array of benefits, which had become a key element in wage agreements and executive compensation. A quirk of history actually touched off the action, when Congress' Joint Committee on Taxation issued a report in 1974 demanding taxation on the value of improvements made to President Richard Nixon's personal residences, and personal use of the presidential airplane (Air Force One). The Treasury under President Ford followed up with a draft of proposed regulations in 1975 taxing fringe benefits unless they were job-related and available to substantially all employees. This "First Draft" was withdrawn in the face of widespread criticism. In fact, in 1978 Congress showed its favorable attitude toward untaxed fringes by authorizing "cafeteria" plans—flexible benefits permitting individuals to select the type and level of benefits best suited to their age and family needs, to the extent provided by an approved company plan—and by specifically barring the IRS from issuing new income tax regulations on fringes until 1980. That moratorium was extended to December 31, 1983 in subsequent legislation. But court decisions and IRS rulings kept the fringes issue boiling. And Treasury staff tax experts continued to press for tighter tax rules on benefits.

The Net Tightens . . .

In the Tax Reform Act of 1984, part of the Deficit Reduction Act, Congress wrote into law "safe harbor" rules protecting some fringes from income and payroll taxes while tightening rules on others. Most importantly, Congress reaffirmed by this statute the principle that fringe benefits are to be treated as income subject to both income and employment (social security) taxes under regulations issued by the IRS, except where exempted by statute. This is intended to bar the door against new untaxed fringes including innovations in executive compensation packages.

What the Future Holds

The fringes "safe harbored" by the '84 law: Qualified employee discounts on plane/train tickets, clothing, etc. (generally not more than 20 percent below market prices); subsidized eating facilities; employer-provided services where the employer's cost is not substantial; working-conditions fringes such as free parking and special clothing items; qualified athletic facilities; subsidized tuition for employees of educational institutions; other benefits too inexpensive or difficult to track (a secretary's typing of a personal letter, for example).

Benefits brought under tighter rules and limits, generally starting January 1, 1986, affect mainly higher-income employees and include Employee Stock Ownership Plans (ESOPs); luxury cars; life insurance above $50,000 in cafeteria plans; "golden parachutes" for top executives caught up in mergers; Voluntary Employees Beneficiary Associations (VEBAS) providing upper-range insurance and pension benefits.

The real bite in the 1984 law will come when the IRS regulations are written and enforced. A hint of the complexities these rules will spawn is found in the January 3, 1985 IRS release of a 72-page booklet of questions and answers about proposed regulations for computing the taxable value of company cars, free airline tickets, child-care aid, etc. In everyday real life, your local IRS agent will decide how to apply these rules—that is, how much tax you and your employer will pay on a given benefit.

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